IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 183 of 1986

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI
and
Hon'ble MR.JUSTICE K.A.PUJ

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

HARSUTRAI J RAVAL

Versus

COMMISSIONER OF INCOME TAX

Appearance:

1. INCOME TAX REFERENCE No. 183 of 1986
MR. MANISHN J. SHAH FOR MR JP SHAH for the Assessee.
MR BB NAIK for the Revenue.

CORAM : MR.JUSTICE R.K.ABICHANDANI
and
MR.JUSTICE K.A.PUJ

Date of decision: 12/02/2002

ORAL JUDGEMENT

(Per : MR.JUSTICE R.K.ABICHANDANI)

The following question of law has been referred for the opinion of this Court under Section 256(1) of the Income-tax Act, 1961 (for short "the Act").

> "Whether, on the facts and in the circumstances of the case, the capital gain of Rs.19,018/- was exigible to tax?"

1. The assessee in respect of the previous year which was S.Y. 2036 (29-10-1979 to 7-11-1980, relevant assessment year 1981-82), had filed Return of income on 20th June, 1981 declaring income of Rs.29,650/-. The assessee's income was from salary, house property, honorarium from the Municipal Corporation and short term capital gain on the sale of building.

2. On 23-3-1979, the assessee had purchased a new house for Rs.45,000/- on which he spent Rs.9,650/- and sold it on 14-5-1980 for Rs.55,000/- claiming deduction of Rs.54,650/and it paid tax on capital gain amount of Rs.350/-. The Income Tax Officer(I.T.O.) noticed that in the earlier assessment year 1980-81, the assessee was given exemption of Rs.19,018/- under Section 54(1)(ii) of the said Act. The I.T.O. held that since the assessee had sold the building which he had purchased on 23-3-1979 within three years of the transfer of the original asset on 16-3-1979, the exemption of Rs.19,018/- allowed to him for the assessment year 1980-81 would go to reduce the cost of the building sold, and therefore, the amount of Rs.19,018/- was required to be added to the income as short-term capital gain. The short-term capital gain was, therefore, increased to Rs.19,368/- from Rs.350/-which was declared by the assessee. The I.T.O. in the same assessment noticed that the assessee had occupied a self acquired property constructed by the assessee. The value of the property as per the balance-sheet filed by the assessee was Rs.95,227/-inclusive of land cost and accommodation. The annual letting value was shown by the assessee at Rs.1200/-per annum which was raised by the I.T.O. to Rs.6000/-per annum.

3. In the appeal filed by the assessee, the Appellate Assistant Commissioner, observed that from the Returns filed for the earlier assessment year 1980-81, it was noticed that the assessee did not make any categorical statement as to why he was claiming exemption under Section 54(1)(ii) of the said Act and that he neither stated that the exemption was admissible because

he had purchased property on 23-3-1979; nor did he state that the exemption was admissible on account of completion of construction of another property. The assessee had completed construction of his property on 29-5-1980 which he was occupying, as noted in the order of the I.T.O., after having sold on 14-5-1980 the property which was purchased by him on 23-3-1979. The C.I.T. (Appeals), noted that the assessee did not utter even a single word at the time of hearing for the assessment year 1980-81 that he had constructed another property also, and therefore, the I.T.O. was correct in drawing an inference that the exemption was claimed on account of the purchase of the property under the sale-deed dated 23-3-1979. The C.I.T.(Appeals), further observed that since the assessee had constructed the other property, he could legally claim exemption under Section 54(1)(ii) in the assessment year 1980-81 on account of completion of the construction of the property, and therefore, the amount of Rs.19,018/- which the assessee was legally entitled to adjust should not have been added in his income.

4. The Revenue preferred an appeal against the order of Appellate Assistant Commissioner and the Tribunal, by its order dated 3rd February, 1986 allowed the appeal and restored the order of the I.T.O. The Tribunal noted the undisputed fact that the original residential house property of the assessee was sold by him on 16th March, 1979 for Rs.71,000/- and that he had earned long term capital gain of Rs.19,018/-thereon. He had then purchased a house on 23-3-1979 for Rs.45,000/- and had claimed that the capital gain of Rs.19,018/- was not taxable in assessment year 1980-81. He had filed copy of the sale deed of the original asset as well as purchase-deed of the new property. The I.T.O accepted the claim and the capital gain of Rs.19,018/- was treated as exempt from tax in the assessment year 1980-81. The assessee spent Rs.9,650/- on the house purchased on 23-3-1979 and sold it on 14-5-1980 for Rs.55,000/- showing a short-term capital gain of Rs.350/- in his Return for assessment year 1981-82.

4.1 It was contended by the Revenue before the Tribunal that provisions of Section 54 gave no option to the assessee as to when he should claim benefit provided thereunder or with respect to the house properties which the assessee may have purchased or constructed during the said period. The contention was that the I.T.O was bound to grant benefit to the assessee in respect of the house purchased on 23-3-1979 which was treated to be the new asset within the meaning of Section 54(1)(ii) of the Act,

and since that new asset was sold within three years, the I.T.O. was justified in reducing the cost of the new asset by the amount of capital gain of Rs.19,018/- under Section 54(1)(ii) of the Act.

4.2 The stand of the assessee was that alongwith the Return for A.Y.1980-81, the assessee had indicated that the capital gain earned on the first house property sold on 16-3-1979 were to be adjusted against the house property which was under construction and the construction was in fact completed on 29-5-1980. According to the assessee, the house property purchased on 23-3-1979 was purchased by way of a stop gap arrangement as the assessee was constructing a house property and construction thereof was completed on 29-5-1980.

4.3 The Tribunal, after considering the provisions of Section 54(1), held that the fact that the purchase of the house property on 23-3-1979 was made by way of a stop gap arrangement was of no consequence, and that, in the instant case, provisions of second part of clause (ii) of Section 54(1) would be attracted. Since the new asset was sold on 14-5-1980 i.e. within three years of its purchase, its cost had to be reduced by the amount of capital gain of Rs.19,018/-. It was held that the I.T.O. had correctly worked out the capital gain as per Section 54(1)(ii). It will be noted from para 9 of the order of the Tribunal that it has read the words "whichever is earlier in Section 54(1)(ii) which are not there in that provision while holding that " the provisions of this section would be attracted in respect of the house property purchased or constructed whichever is earlier.

5. It was contended by the learned Counsel appearing for the assessee that under Section 54(1), the capital gain that accrued to the assessee on sale of the original asset could not have been charged to income-tax as the income-tax of the previous year in which the transfer took place and was required to be dealt with in accordance with the provisions of clause (1) or (2) of Section 54(1) as may be applicable. He submitted that the house which was purchased on 23-3-1979 i.e within a few days after the sale of the original asset on 16-3-1979 was purchased only by way of a stop gap arrangement because the permanent house of the assessee was under construction. According to him this was clear from the fact that the property purchased on 23-3-1979 was sold on 14-5-1980, just a few days before the construction of his house was completed on 29-5-1980. It was submitted that as per the statement of income for

assessment year 1980-81, copy of which was placed on record, the assessee had filed his Return in Ward A, Rajkot on 17-6-1980 and i.e. after the construction of the assessee's house was completed on 29-5-1980. It was argued that the assessee had not specifically claimed exemption against the property purchased on 23-3-1979. He submitted that merely because purchase-deed dated 23-3-1979 was produced alongwith the other documents as mentioned in Statement of Income, it could not be inferred that though the assessee's house was constructed on 29-5-1980 before the filing of Return, the assessee had claimed the exemption in respect of the house purchased by way of stop gap arrangement on 23-3-1979 and not against the house property which he constructed for his permanent residence which was in the assessment year 1981-82 in which the present question has arisen, treated as his self occupied property. It was also submitted that the house purchased by way of stop gap arrangement was not meant for permanent residence of the assessee, and therefore, the exemption of capital gain could not have been adjusted against that house. It was contended that, in any event, the assessee had an option either to purchase or to construct a house for residential purposes during the period allowed by the provisions of Sec.54(1) and when the question of withdrawing the exemption was raised in the assessment year 1981-82, the assessee was entitled to putforth his claim that the capital gain should be adjusted towards cost of construction of the house that he had constructed for his residence. It was firstly argued that the very basis of the reasoning of the Tribunal that the claim for exemption was to be adjusted against the house property purchased or constructed " whichever earlier" was not warranted by Section 54(1).

6. The learned Counsel for the assessee, in support of his above contentions referred to the following decisions:

(a) A decision of the Bombay High Court in K.C. KAUSHIK V. P.B.RANE, FIFTH INCOME TAX OFFICER, AND OTHERS, reported in (1990) 185 ITR 499,was cited for the proposition that, in absence of any provisions to the contrary, the assessee was entitled to avail of the capital gain against any one of the two flats in respect of which the assessee had chosen to seek relief. In that case the assessee had purchased a flat in 1979 and another flat in 1980 and had chosen to seek relief against the flat purchased in 1980. It was held that it was for the assessee to claim

relief under Section 54(1) against the purchase of any one of those flats.

(b) A decision of the Calcutta High Court in B.B.SARKAR V. COMMISSIONER OF INCOME-TAX, WEST BENGAL-IV reported in (1981) 132 ITR 150 , was referred to for the proposition that the main purpose of Section 54 is to give relief in respect of profit on the sale of a residential house and if an assessee was entitled to such relief on the fulfilment of either of the two conditions, that is to say, either purchase a house property within one year or construct the house within two years, it would be improper to hold that on fulfilment of both conditions, he will not be disentitled to that relief. In that case the assessee had after selling his dwelling house on 26th July, 1974 purchased a house property on 13t June, 1976 and made a further investment in it before March 27, 1976 by constructing an additional floor thereon. It was held that where both the conditions were fulfilled within the time stipulated, the assessee would be entitled to the relief.

(c) A decision of the Andhra Pradesh High Court in the case of COMMISSIONER OF INCOME-TAX V. SMT. D. RANI reported in (1996) 218 ITR 724 was referred to for the proposition that the words " in the two years immediately preceding the date on which the transfer took place" in Section 54(1) are used to indicate continuous residence not necessarily for two years, in contradistinction to mere casual stay or occasional stay for a short period without there being intention to stay permanently.

7. The learned Counsel for the Revenue supporting the reasoning of the Tribunal contended that since the assessee had in his Return for the earlier assessment year 1980-81 disclosed the capital gain of Rs.19,018/- on the sale of his residential house and also produced purchase deed of " Raiya Road House", the Income-Tax Officer granted exemption in respect of the capital gain under Section 54(1)(ii) of the Act. It was submitted that at the end of the accounting year relevant to the assessment year 1980-81, the house which was under construction was not yet completed, and therefore, there was no question of adjusting the exemption claim against the house which was under construction. It was argued that when the factum of purchase of another house was

placed on record by producing purchase-deed, it was not necessary for the Income-Tax Officer to wait until the completion of the construction of the other house and on the basis of the material available, the Income-Tax Officer correctly accepted the deduction claimed by the assessee by virtue of exemption under Section 54(1)(ii) of the Act adjusting it towards the cost of the house purchased on 23-3-1979. It was further contended that the option once exercised could not be shifted from the house purchased to the house constructed, even if the construction was completed within two years from the date of the transfer of the original asset and that there was no option available to the assessee, once the exemption of capital gain is allowed against the first property purchased.

8. The facts are in a narrow compass and the dates are not disputed. The residential house was sold by the assessee on 16th March, 1979 which had resulted in capital gain of Rs.19,018/- to him. In the Return filed on 17-6-1980, as per the Statement of Income, the capital gain on the original asset was shown and exemption under Section 54(1)(ii) of Rs.19,018/- was claimed showing taxable capital gain as nil. The assessee while claiming exemption did not specify that he was claiming it against any particular property. Before the Return was filed on 17-6-1980, the house which was under construction was sold on 14-5-1980, on which date, its construction was completed. In the assessment year 1980-81, neither the assessee nor the Income-Tax Officer pegged the adjustment of capital gain against a specific property, that is, the house purchased or the house constructed. The question, however, arose in the year 1981-82 when the Income-Tax Officer, noticing that the house which was purchased on 23-3-1979 was sold away on 29-5-1980 withdrawing the exemption by assuming that it was adjusted towards the house purchased and rejecting the assessee's claim that he wanted the adjustment of capital gain from the original asset against his residential house, the construction of which was completed on 14-5-1980 prior to the filing of the Return for the assessment year 1980-81.

9. The provisions of Section 54 (1) as operative at the relevant time read as under:

" Where a capital gain arises from the transfer of a capital asset to which the provisions of section 53 are not applicable, being buildings or lands appurtenant thereto the income of which is chargeable under the head " Income from house property" which in the two years immediately

preceding the date on which the transfer took place, was being used by the assessee or a parent of his mainly for the purpose of his own or the parent's own residence [(hereinafter in this section referred to as the original asset)], and the assessee has within a period of one year before or after that date purchased, or has within a period of two years after that date constructed, a house property for the purposes of his own residence, then, instead of the capital gain being charged to income-tax as income of the previous year in which the transfer took place, it shall be dealt with in accordance with the following provisions of this section, that is to say,-

(i) if the amount of the capital gain [is greater than the cost of the house property so purchased or constructed (hereafter in this section referred to as the new asset)]. the difference between the amount of the capital gain and the cost of the new asset shall be charged under section 45 as the income of the previous year; and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of three years of its purchase or construction, as the case may be, the cost shall be nil; or

(ii) if the amount of the capital gain is equal to or less than the cost of the new asset, the capital gain shall not be charged under section 45; and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of three years of its purchase or construction, as the case may be, the cost shall be reduced by the amount of the capital gain."

10. The above Section 54(1) deals with capital gain arising from the transfer of property which was used for

residence by the assessee or his parent for two years preceding the transfer. If the assessee within one year of the transfer, purchases or within two years, constructs a house property " for the purpose of his residence ", then, instead of capital gain being charged to income-tax as, income of the previous year in which transfer took place, it shall be dealt with as provided thereunder.

10.1 It will be noted from the provisions of Section 12(B)(iv)(b) of the Indian Income-Tax Act, 1922 which corresponded to Section 54(1) that the capital gain arising out of the original asset was to be treated in accordance with clause (1) or (2) of that provision " if the assessee so elects in writing before the assessment is made". In other words, under Section 12(B)(iv)(b) of the Act of 1922, the special provisions devised for dealing with the capital gain arising from the sale of the original asset were to operate only if the assessee so elected in writing before the assessment was made. In Section 54(1) of the Act of 1961, the application of the special provisions contained in clause (i) and (ii) of Section 54(1) does not depend on any election by the assessee and operate in all cases falling within Section 54(1). Under Section 54(1), capital gain is not to be charged to tax to the extent it has been utilised for purchase or construction of the new asset within the period stipulated. The words " then, instead of capital gain being charged to income-tax as income of the previous year in which transfer took place, it shall be dealt with as provided in clause (i) and (ii) would mean that even if capital gain arises in the previous year in which transfer of the original asset took place, it will not be deemed to be the income of the previous year in which transfer took place. The provisions of Section 54(1) will prevail over the deeming fiction of Section 45 of the Act which treats capital gain as the deemed income of the previous year.

10.2 Under Section 54(1), the assessee has an option to purchase house property within one year of the transfer of his residential property or to construct his own residential property within two years of such transfer. The ascertainment of the difference between the cost of the house property so purchased within one year or constructed within two years of the transfer of the original asset and the amount of capital gain arising from the original asset can take place only when the new asset is purchased or constructed as the case may be. It, therefore, follows that the assessee cannot be subjected to pay income-tax on his capital gain which is

not to be treated as his deemed income of the previous year in which transfer took place until the expiry of the outer limit of one and two years in case of purchase and construction respectively, at the end of which alone, it could be possible to compute difference between the amount of capital gain and the cost of the new asset, and it is, at that stage, that the question of charging such difference under Section 45 as income of the previous year can arise. The Income-Tax Officer, unless the transfer or purchase or construction of the new asset has already taken place in the previous year, must wait till such purchase or construction takes place within the stipulated outer time limit when he can work out the difference under the special provisions of Section 54(1). Therefore, merely from the fact that the capital gain was not charged to tax in the previous year of the transfer, it cannot be inferred that the benefit of adjustment under Section 54(1) was availed of by the assessee in the previous year though he had not purchased or constructed a new asset for residential purpose. It would be in consonance with Section 54(1) of the Act, if the Income-Tax Officer, instead of charging capital gain to income-tax in the previous year in which transfer of original asset took place, waits till the outer period of one year for purchase or two years for construction when he could work out the difference for charging it as income for the previous year, unless there is a communication on record that the event of such purchase or construction is not to take place or that it has already taken place, during the assessment proceedings, the Income-Tax Officer can always enquire during the assessment proceedings from the assessee as to whether he has purchased or constructed or intends to do so, a house for his residential use, and if the house is already purchased or constructed, the capital gain can be adjusted. If the purchase or construction took place within the previous year in which the transfer of original asset took place, the Income-Tax Officer will be in a position to work out the difference for the purpose of complying with the provisions of Section 54(1) (i) or (ii) as may be applicable for the assessment year relevant to the previous year, and in such an event no question of waiting till the purchase or construction is made within their respective outer time limits would arise. In cases, however, where the capital asset from transfer of the original asset is charged to tax and within one year of such transfer the assessee purchases or within two years constructs for his own residence a house property, the Income-Tax Officer is bound to amend the order of assessment so as to exclude the amount of capital gain not chargeable to tax under Section 54(1),

as laid down in Section 155(8) of the Act.

10.3 In the Department Circular no.495 dated 22nd September, 1987 while elaborating the provisions of the New Scheme for deposits in respect of exemption from capital gains the CBDT observed that capital gains arising from transfer of the original asset were under the existing provisions of Ss. 54, 54B, 54D & 54F exempt from income tax if such gains are reinvested in new assets within the time allowed for the purpose and that "the original assessment needs rectification whenever the tax payer fails to acquire the corresponding new asset", and that " With a view to dispense with such rectification of assessments, the amendments made to Ss.55,54,54B, 54D and 54F provide for a new scheme for deposit of amounts meant for reinvestment in the new asset." Thus, even the department has viewed the capital gains arising from the transfer of original asset as exempt from income tax. This will also be clear from the Form II of Return prescribed under the relevant rules then prevailing, which provided for deduction, inter alia, of the amount exempt under S.54. This is in tune with the above interpretation of Sec.54(1) that the capital gains cannot be charged to income-tax in the previous year in which the transfer of original assets takes place and the I.T.O. can charge it only when the event of purchase or construction takes place within the time limit prescribed or when the assessee fails to purchase or construct, as the case may be.

11. An important aspect that underlies Section 54(1) is that the benefit of Section 54(1) will apply in case of the house property which is purchased or constructed for assessee's own residence. The provision does not restrict the assessee from buying more assets but gives him an option to purchase or construct and claim the benefit against the property so purchased or constructed for his residential purpose. Therefore, if a property, though newly purchased or constructed, is not meant to be used for the purpose of residence by the assessee and the assessee within two years of the transfer of the original asset purchases constructs another house property which he intends to use for residential purposes, he will be entitled to claim the benefit of Section 54(1) in respect of the new asset which he has purchased or constructed for his residential purpose. In other words, the fact that nearer to the date of transfer of the original asset, the assessee had purchased or constructed any house property for purposes other than residential will not take away his entitlement to claim the benefit qua the new asset meant for residential purpose.

The expression " for the purpose of his own residence" in Section 54(1) would suggest that the benefit of the provision is intended for the new asset which is meant at the time of purchase or construction, to be used for the dwelling purposes by the assessee and this will rule out use by way of mere temporary occupation which will not be a use for permanent residence. The word " residence" has a variety of meanings, according to the statute in which it is used and position in which it is found. The word "residence" in the present context refers to a place of permanent and not merely temporary abode. The word permanent here, is a relative term and is not synonymous with everlasting. A stop gap arrangement for stay in a house property not intended to be purchased or constructed for permanent residence, that is, as an abode where the assessee would ordinarily dwell, cannot deny the entitlement to the benefit of the provisions of Section 54(1) to a person who has, until his regular residential house property for his permanent, residence,(that is , indefinite period, as opposed to temporary residence) is constructed within two years, made such stop gap arrangement for his stay or temporary occupation during the intervening period. Therefore, if an asset purchased or constructed not for residential purpose, but only for temporary accommodation, is transferred within three years, that will not affect the benefit that attaches to the purchase or construction of the new asset for residential purposes and no question of reduction of cost by the amount of capital gain will arise qua the transfer of the asset which was not purchased or constructed for residential purpose. The transfer within three years of the asset not purchased for residential purpose as contemplated by Section 54(1), would be an independent transaction and sale of such asset to which no benefit of Section 54(1) applied would not attract clause (ii) of Section 54(1) of the Act. In other words, entitlement to adjust capital gain qua purchase or construction for residential purposes would still operate under Section 54(1) against the house property purchased or constructed for permanent residence by the assessee.

12. The disclosure of capital gain of Rs.350/- in respect of the sale of the asset which was purchased on 23-3-1979 and sold on 14-5-1980 was made by the assessee in his Return for the assessment year 1981-82 . That transaction stood on a different footing and Section 54(1) did not apply to it. The transfer on 16-3-1979 of the original asset used for residential purpose and construction of house for residential purpose completed

on 29-5-1980 provided adequate time and purpose nexus that underlies Section 54(1) making the assessee entitled to the benefit of Section 54(1) and since the constructed residential property was not transferred within three years, there was no event which would justify withdrawal of the benefit by invoking clause (ii) of Section 54(1) of the Act. Since construction was completed on 29-5-1980 before the Return for the assessment year 1980-81 was filed on 17-6-1980, it was open for the assessee to claim adjustment of the capital gain against that house and in view of such entitlement, the Income-Tax Officer could not have denied the benefit to the assessee on the ground that he had earlier purchased a house property on 23-3-1979 which, as is clear from the facts on record, was used by way of a stop gap arrangement. The Tribunal was in error in observing that it did not matter whether the house was purchased by way of stop gap arrangement. The fact that it was purchased as a stop gap arrangement was a significant fact and could not have been brushed aside for the purpose of denying the entitlement of the assessee to adjust the capital gain against the house that he constructed which was meant to be his permanent residence.

12. For the above reasons, we hold that the Tribunal has committed an error of law in holding that capital gain of Rs.19,018/- was exigible to tax. The question referred to this Court, is therefore, answered in the negative in favour of the assessee and against the Revenue. The Reference stands disposed of accordingly with no order as to costs.

(R.K.Abichandani,J.)

(K.A.Puj,J.)

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